



Mika Vidlund

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Finnish Centre for Pensions
Working Papers
2006:1

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Edita Prima Oy

Helsinki 2006

ISBN 951-691-052-1 (nid.)

ISBN 951-691-053-X (PDF)

ISSN 1795-2697

ABSTRACT

The aim of this article is to compare old-age pension reforms in the decades of retrenchment in the EU-15 countries. The emphasis is on reforms that indicate structural changes of old-age pension systems. The study is inspired by and has its framework in institutionalist theory and visions of path-dependency arguing for stability or path-conditioned changes. The analysis is based on trichotomies presented by Hall and Pierson. The degree of structural change and magnitude of retrenchment will be measured by replacement rate calculations. A majority of the recent reforms can be labelled parametrical, which seem to leave the basic principles of the system intact. However, the results indicate that the landscape of pension systems is not as frozen as is often argued even though reforms established in different countries have similarities according to the welfare state types they belong to.

Key words: *retrenchment, path dependency, pension reform, EU-15 countries, old-age pension systems*

ACKNOWLEDGEMENTS

I would like to thank especially professor Olli Kangas for guiding my work. His enthusiasm and several comments throughout the whole period were invaluable. I would also like to thank professor Veli-Matti Ritakallio for helpful comments. I am also grateful to professor Hannu Uusitalo and docent Seija Ilmakunnas for their comments. Finally I would like to thank Janina Gröndahl for checking my spelling and Merja Raunis for the layout of this paper. Any comments concerning this paper should be sent to author.

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1 Introduction

Reforms of pension schemes have been high on the political agenda of almost all developed countries in recent years. Nowadays much of the discussion revolves around population ageing, globalization, economic competitiveness and the adaptation of existing pension systems to new challenges. Recent comparative welfare state research has largely described this adaptation process as a retrenchment of the welfare state. According to the developmentalist or functionalist model, we can summarize the historical development of welfare states, and likewise pension systems, into four different sections: emergence (late 19th century until 1945), growth (the golden age, WW II to the 1970s), limits (crisis of state-centred social policy) and retrenchment (since the late 1980s) (see also Palier 2000, 4).

According to Pierson (1996), the politics of retrenchment is very different from that of welfare state expansion. Retrenchment includes policy changes that either cut social expenditure, restructure welfare state programmes closer to a residual welfare state model or alter the political environment in such a way that it enhances the probability of a radical outcome in the future. Likewise Myles and Quadagno (1997) state that retrenchment means targeting universal benefits, reinforcing selectivity and tightening the link between contributions and benefits (e.g. going from a defined-benefit to a defined-contribution model). Bonoli et al. (2000) define retrenchment as a reduction in the role of the state.

However, the dominant view has been that in Western Europe no radical or major retrenchment has occurred. As a consequence it has been argued that welfare states have mainly kept their specific features and stayed quite intact. No major shifts from one welfare regime to another have taken place. The lack of major cutbacks has been explained by the unpopularity of welfare retrenchment among voters, blame-avoidance politics and path-dependency created by the existing social institutions. However, the reform process is not that black and white. As Hacker (2005) has noted, too much attention has been paid to what has not happened to the welfare state and too little to what actually has happened. In much of the existing literature welfare state retrenchment is defined so as to exclude changes that have not caused major institutional reform. Thus, conclusions concerning the stability of welfare states may lead to an underestimation of welfare state cuts. (Dahlström 2005.)

According to Palier (2000), current research should go beyond the notion of retrenchment and find out the different kinds of development that have occurred. Measurement of change should provide an assessment of the degree of innovation introduced by changes. The main question is to clarify whether reforms have introduced new institutions or a new logic or lead to the involvement of new actors (Palier 2001, 5). Pierson (2001) likewise speaks in his later work about new processes of institutional restructuring instead of retrenchment. These are identified as: recalibration, cost containment and recommodification. Recalibration refers to efforts to modify programmes

to fit into new social and economic circumstances. This means updating and rationalisation of the existing system. Cost containment refers to efforts to control budgetary outlays. A new kind of reform policy and altering of existing instruments are needed in order to be able to cut expenditures. Recommodification refers to efforts to enhance work incentives. This is analogous to Esping-Andersen's term commodification, i.e. reducing the level of social security available to those outside the labour market and enhancing attractiveness of the market.

Discussion of retrenchment is particularly interesting when analysing reforms of pension systems. Conclusions concerning the stability of systems could easily be drawn. In pension policy the changes may not be as visible as in other parts of welfare policy because institutional legacies and continuities are there stronger. Hinrichs (2000) has compared pension schemes to elephants when he has analysed the patterns of public pension reform. Like elephants pension systems are large, grey, very popular but difficult to move. Still, historical analysis shows that pension reform policy is a "never-ending story".

How then to define a pension reform and reveal the variation in welfare cutbacks? Perhaps the most well-known trichotomy in addition to Pierson is presented by Hall (1993). Hall's classification is based on hierarchical ordering of the nature of changes. According to Hall, raising the level of pension contribution or changing indexation from wages to prices implies first-order or instrumental changes. Second-order changes are a step deeper, referring to parametric changes in pension policy with introduction of new instruments (i.e. new calculation rules or new entitlement rules). Third-order change involves a paradigmatic change, referring to simultaneous changes both in instruments and the hierarchy of goals behind the policy, changing the overall logic of pension policy. There is a clear analogy to Pierson's classification. Hall's first and second-order change as well as Pierson's recalibration and cost containment can be seen as normal policymaking without challenging the overall terms of a given policy paradigm. Third-order change and recommodification, by contrast, reflect radical changes and a paradigm shift.

However, previous studies have shown that the difference between the first and second order of change is not that clear and it is not always so that first-order change is necessarily less important than second-order change. Neither is the division that clear when we observe a longer period of time (see e.g. Hinrichs & Kangas 2003). Also smaller changes may lead to a more structural change. Parametric reforms reducing the benefit level in a statutory pension scheme make private saving much more necessary than before. This may over time result in a quite different structure of income in retirement and thus in a structural change. Thus, cumulative strategy is an alternative to a dramatic change. This is an important point of view concerning especially pension changes. Usually the changes in pension policy are gradual.

Hacker (2004) likewise speaks about stepwise changes or more precisely hidden forms of retrenchment: drift, conversion, layering and revision. The first form of retrenchment refers to a transformation of a stable policy due to changing circumstances. The system is "drifting" in a new direction as policies remain the same. Conversion is about internal adaptation of an existing policy. Policies are restructured to adapt better to changed surroundings. Layering is creation of a new policy without elimination of the old. And finally, revision is a replacement or elimination of an existing policy, referring to Hall's 3rd order change.

However, possibilities to reform the pension system depend largely on the characteristics of the system. According to the institutionalist approach, certain institutional prerequisites facilitate or inhibit changes. It has been stated that in pension policy path-dependency, i.e. institutional factors, structure of the pension system itself, is a decisive precondition to the way reforms are enacted.

Structural classification analysis by Korpi and Palme (1998) has been widely used for analysing social insurance programmes and their institutional structures. Their classification has been further developed in later research studies (e.g. Bonoli & Palier 2000; Palier 2001; Kangas 2004; Natali 2004) and five dimensions decisive for shaping the development of welfare programmes have been separated. These dimensions are eligibility (i.e. entitlement to benefits), benefit structure (flat-rate or earnings-related benefits), administration (management of the schemes), financing (contribution or taxes) and arena of decision-making (public, i.e. state and politics, or private, i.e. social partners, markets).

Previous studies have shown that pension systems which are based on earnings-related benefits; primarily financed by pension contributions paid by employers and employees; and where the social partners have a decisive role are most resistant to change. These are all typical elements of Continental welfare states, which are qualified as conservative and corporatist by Esping-Andersen (1990). The countries of Southern and continental Western Europe share a common institutional architecture. In these countries the pension scheme is also generous and among the population there is a strong commitment to the pension which is considered as deferred wage.

Typically a pension system that is managed by the social partners is also highly fragmented, i.e. the pension scheme covers a certain occupational group or category of people. This makes the reform efforts even more difficult. Occupationally segregated schemes tend to create strong intra-group interests (Kangas 2004). The role of unions has been highly visible in recent years. Especially France, Greece and Italy have all witnessed strikes and demonstrations against pension reforms. Likewise union consent has been decisive for previous successful reforms. When policymakers' efforts to recast pensions were supported by trade unions (e.g. the Balladur Reform in France in 1993, the Schroeder Reform in Germany in 2001 and the Dini Reform in Italy in 1995), new laws were

approved. When governments tried to reform unilaterally they failed (the Juppé reform in France in 1995, the Kohl Renten Reform in Germany in 1999 and the Berlusconi plan in Italy in 1994). On all of these occasions, trade unions acted as reform-blocking veto players. (Natali & Rhodes 2004.)

The situation is quite the opposite in comparison to countries with universal or residual pension schemes, which are usually under the state's control and decisions to reform such schemes are made in the political arena (Korpi & Palme 2003). Korpi and Palme (2003) emphasize also the role of the middle classes in different welfare models. In residual or universal basic security schemes the middle classes lack specific interest and intra-group solidarity strong enough to bring them onto the barricades.

In sum, according to the institutional reform scenario, it can be assumed that institutional arrangements make it is easier to reform universal and residual schemes. It can also be assumed that countries will implement policy measures that are in line with the welfare state type to which they belong. Thus reforms in Nordic countries are more about cost-containment with relatively little recalibration and recommodification. In Anglo-Saxon countries reforms are more the opposite: reforms prioritise recommodification and cost-containment. In-between there are the Continental countries where reforms are characterised by recalibration and cost-containment. (Pierson 2001.)

In addition, Sarah Brooks (2001) argues that countries with a high public debt to GDP ratio are less likely to privatize their pension programmes because they cannot afford the transitional costs associated with moving from a public PAYG system to fully-funded individual accounts. Among those countries that do privatize, however, differences in debt burdens do not significantly shape the degree of privatization chosen. Likewise Holzmann et al. (2005, 65) argue that a country with high implicit pension debt is likely to exclude a move towards a funded pillar. The transition from PAYG towards full funding makes the implicit debt explicit. Countries where the system is mature as regards both benefit levels and coverage have high implicit pension debt levels. In other words, this means that traditional social insurance countries are unlikely to privatize their pension schemes.

If so, reforms only reinforce the logic of each traditional welfare system. Esping-Andersen (1996) has described this kind of development with the term "frozen welfare landscape". This will bring us to the central focus of this paper.

1.1 Aim, measurement and data

This paper seeks to explore the variation in old-age pension reforms in the "old" EU countries, i.e. EU-15 countries. The focus is on recent pension reforms, i.e. in the period of retrenchment starting at the end of the 1980s or at the beginning of the 1990s according to the developmentalist model. The aim of this study is to investigate to what extent it is possible to speak about changes of the 1st, 2nd and 3rd level. What if we include the time

span of 20 to 50 years? How much and in what ways have pension systems then changed? The argument presented here is that the explanation of policy persistence of the institutions and institutional stickiness is too simplistic if the effect of time is not taken into account. This paper contributes to the discussion of pension reforms and attempts to find out how frozen the welfare landscape actually is. The role of politics and political institutions in pension reform has been left outside this paper. The aim here is only to clarify whether institutions matter. It is a task for future studies to show how politics matter, given the structural constraints.

The measurement of change will be based on Hall's and Pierson's classifications. Some earlier studies have also emphasized the importance of quantitative measurement, or to be more precise: lack of it (see e.g. Powell 2004). The ideal way to measure social policy retrenchment is to compare the situation before and after the policy change. In the field of social policy micro-level measurement is important. Retrenchment is above all changes in individual entitlements and benefit levels. Macro-level comparisons are more common, e.g. changes in the future pension expenditure level. However, aggregate expenditure levels are not good to reveal retrenchment as, for example, an ageing population might show up in increased public expenditure. To ascertain the magnitude of the pension reforms retrenchment will be measured through replacement rate calculations. Calculations concern a hypothetical worker retiring today and in future years. This will help us to ascertain whether also incremental changes actually have led to a system shift after development over a longer period.

Replacement rate calculations are derived from data published by the EU's Social Protection Committee (later on SPC) and Economic Policy Committee (later on EPC). Otherwise official material published by national authorities like the National Pension Strategy Reports (later on NPSR) and further secondary sources will be used in this study to answer the aforementioned questions. To describe the economic-demographic environment Eurostat statistics and population projections are used, as is data published by the EPC for public pension expenditure projections.

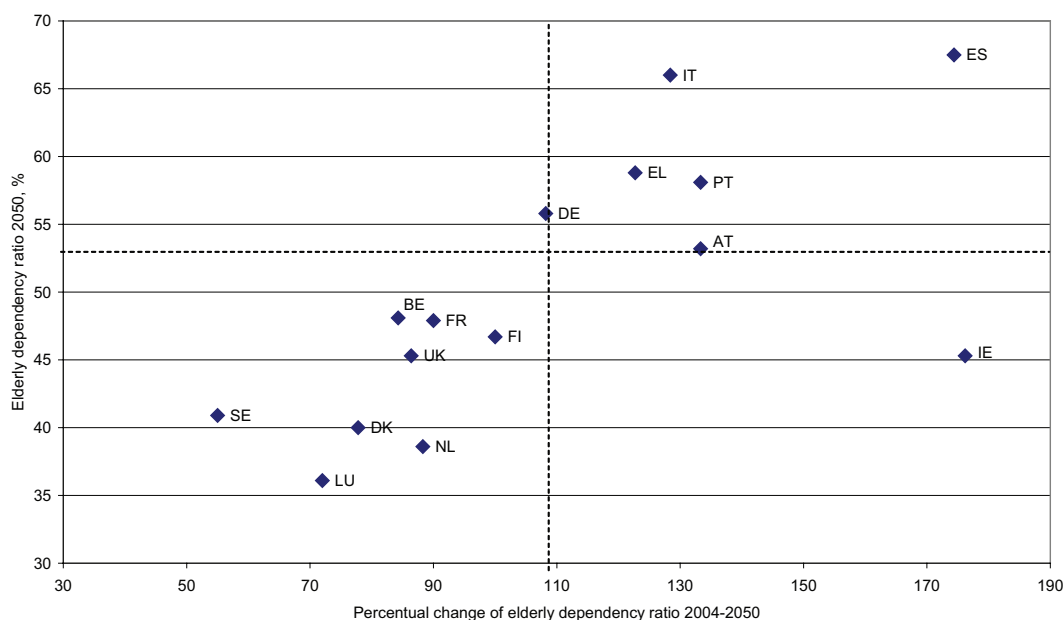
The rest of this paper is structured as follows. First, I will give a short economic-demographic overview of the pressures countries are facing. The chapter depicts the factors that have strongly influenced and stimulated a shift from Pierson's (2001) "enrichment politics" to the "politics of retrenchment". Thereafter I will review overall patterns of pension reforms in the countries studied. Then I will try to ascertain the degree of retrenchment using the calculations of pension replacement rates. Finally concluding remarks are made.

2 The need for pension reform - Economic-demographic overview

Needless to say, the most important source of pressure for pension reform is an ageing population. Demographic challenges vary across the EU-15 countries but each country faces the same problem, on average the old-age dependency ratio will double by the year 2050 (see Figure 1). Population ageing is rapid especially in Spain but also in Ireland, where the population structure is more advantageous (younger) though. Spain, Italy, Greece, Portugal, Germany and Austria form a group of countries of rapid ageing and high old-age dependency ratio. Other countries are in a more favourable situation when comparing the situation in 2050 in the EU-15 countries.

It is interesting to notice that Sweden that has carried out so far the most radical pension reform in the EU-15 countries has one of the most favourable demographic trends when compared to other EU-15 Member States. The increase in old-age dependency ratio is projected to be very slow, growing from a moderate 26.4% in 2004 by just 14.5 p.p. up to 41% in 2050.

Figure 1. The change in old-age dependency ratio (65+/15–64) and the situation in 2050 in the EU-15 countries.

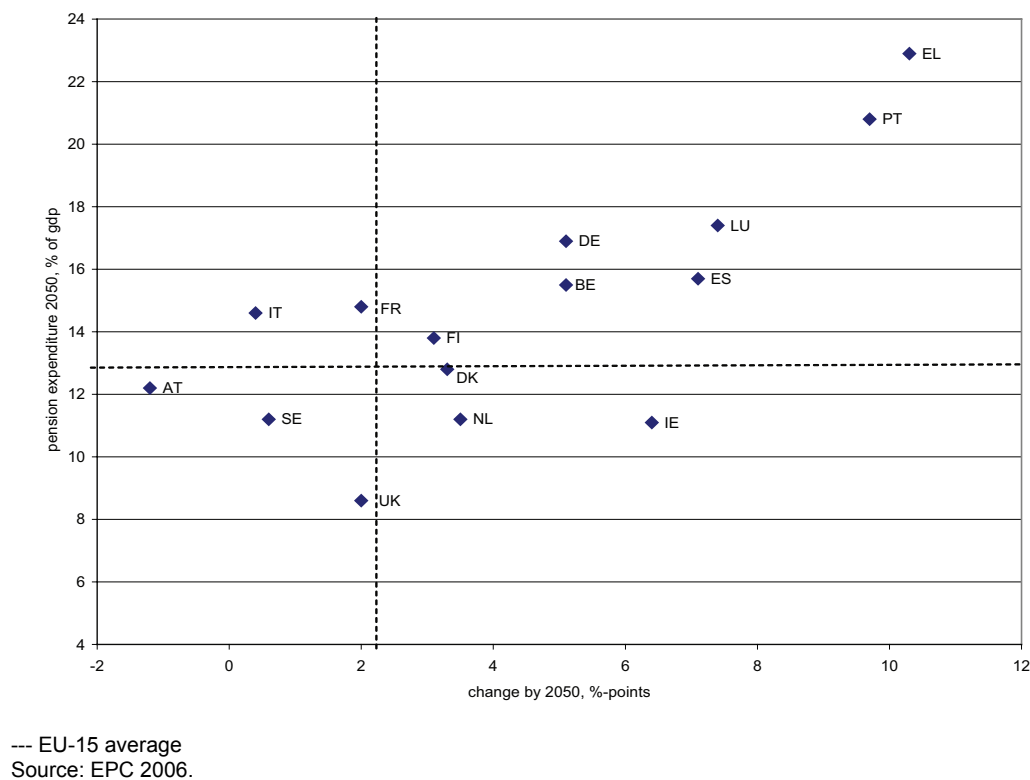


--- EU-15 average
Source: Eurostat 2005.

Population ageing has a direct impact on future pension expenditure. Rise in life expectancy, and also the trend of early retirement in many countries lengthen the average period during which the pension is drawn. Thus, another pressure for retrenchment is the link between pension policy and employment. Higher employment eases the burden for financing pensions. Raising employment rates of older workers is an important element in the EU countries' long-term strategy for making adequate pension provision financially sustainable. Common targets have also been set at the EU level. At the moment, many EU countries fall short of what is required to achieve the Stockholm and Barcelona targets for the employment rate of older workers (50% by 2010) and for an increase in the effective retirement age by five years by 2010.

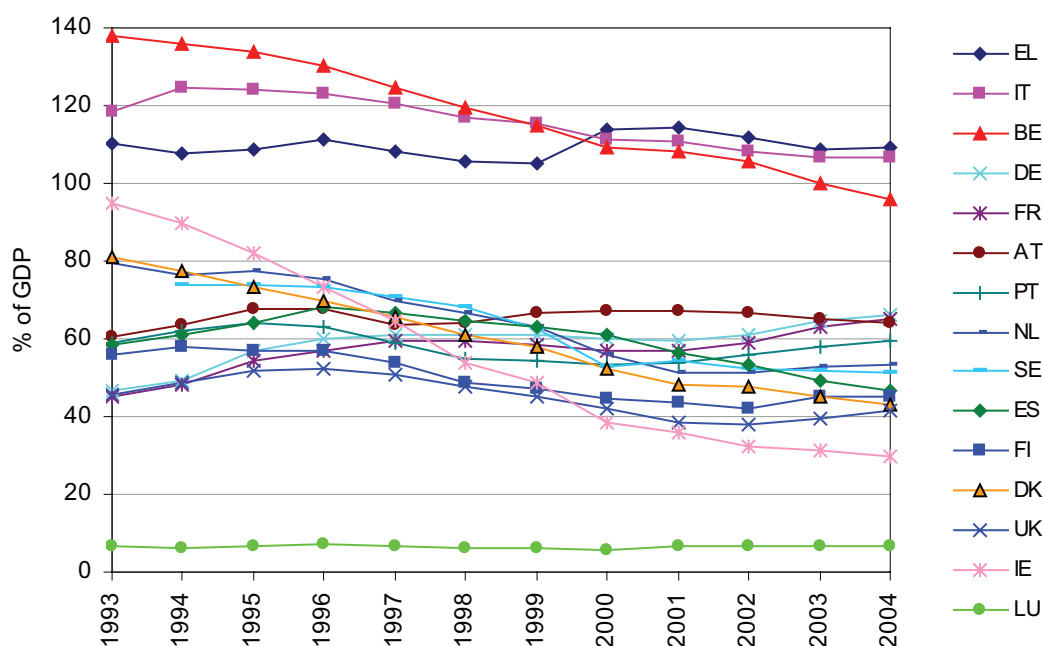
The difference between pension expenditure in 2050 and 2004 reflects above all population ageing as shown in Figure 1 but also the scope of the public pension system in each country. Countries of Continental and Southern Europe largely share a common benefit structure and thus have a higher pension expenditure level. In the EU-15 Member States the pension expenditure is projected to increase from 10.6% in 2004 to 12.9% by 2050.

Figure 2. Public pension expenditure in the EU-15 countries in 2004 and in 2050 (% of GDP).



The third source of pressure for retrenchment in public pension systems is the overall fiscal situation of the public sector. Government deficit and debt limit the choices that can be made. Debt is here used as a pressure indicator, because it better reveals the long-term development if compared to a deficit that indicates the money flow in one year. The EMU criterion of acceptable level of debt has been set at 60% of GDP and at the moment six countries break this limit and the pressure to cut expenditures is highest in Greece, Italy and Belgium. However, Italy and especially Belgium have managed to reduce the debt if compared to the level in the 1990s. On the contrary, the general government debt has increased most in Germany (46.9% in 1993 to 66.4% in 2004) and France (likewise 45.3% to 65.1%). According to the forecasts of the European Commission (2006), Greece and Portugal face a high risk while Denmark, Austria, Finland and Sweden are at low risk with regard to the long-term sustainability of public finances (up to 2050). The remaining EU-15 countries are at medium risk.

Figure 3. General government debt as a percentage of GDP, 1993–2004.



Source: Eurostat 2006.

Perhaps the most descriptive way for summarizing the overall economic-demographic challenges is provided by the European Commission, which on the basis of the Member States' national pension strategies has evaluated the financial sustainability of public pension systems. As a result countries have been grouped into four different categories,

taking together population and employment developments as well as the development of pension expenditures and the overall public finances (Tables 1 and 2).

Table 1. *Financial sustainability of public pension schemes in EU-15 countries in 2006.*

<u>"No major challenges"</u> SE, UK	<u>"Moderate challenges"</u> FI, DK, DE, IT, FR, IE, NL, AT
<u>"Important pressures"</u> BE	<u>"Significant challenges"</u> ES, PT, EL, LU

Source: COM (2006) 62 final.

Table 2. *Financial sustainability of public pension schemes in EU-15 countries in 2003.*

<u>"well prepared"</u> SE, UK	<u>"manageable"</u> FI, DK, BE, IE, NL, LU, PT
<u>"further reforms needed"</u> IT, DE	<u>"...indeed needed"</u> EL, ES, FR, AT

Source: European Commission 2003.

However, it is worth mentioning that this classification does not give the whole picture of pension systems' performance. What we are missing here is the adequacy of pension systems. With this in mind, it can be seen that Austria, France, Germany and Italy have managed to climb up in the categorization when compared to the situation in 2003. On the other hand, demands for reform have increased in Belgium, Portugal and Luxemburg. Likewise, pressures for reforms continue to be high in Greece and Spain. At the other end are Britain and Sweden, which have managed to keep their position in the "first class".

This raises the question of what kind of pension reforms different countries have carried out and the magnitude of these changes as countries cope with the challenge of the sustainability of pension systems. These will be studied more closely in the following chapters.

3 Pension reforms applied in the countries studied

Several countries have adopted a plethora of reforms to ease the pressures caused by an ageing population. To put it briefly, it is possible to distinguish some general measures among the variation of pension reforms. First of all the link between contributions and benefits has been tightened. This is most visible in Italy and Sweden, where a notional defined-contribution system has been established. Countries following the defined-benefit principle have increased the calculation period of pensionable earnings to the entire employment career instead of the "best years" or the "last years" principles (e.g. Austria, Finland, Portugal).

Second, pension indexations are no longer based on wage development but rather on changes in cost of living (or on increased weight of the inflation component in a mixed indexing formula) or on lower adjustments by incorporating other parametric components in the formula (as in Sweden and Germany).

The third measure is the prefunding of pensions. Nearly all EU-15 countries have established a partial prefunding in the 1990s or early 2000s. Only Germany, Italy, Austria and Britain have no prefunding in their statutory pension systems. On the contrary, Luxembourg, Sweden, Denmark and Finland have had partial funding for a longer period of time. For example in Finland partial prefunding was established already when the earnings-related private-sector employees' pension scheme was implemented in 1961.

Fourthly, measures aiming at raising the effective retirement age. This includes several measures like abolition of early retirement pathways, raising the retirement age, making the retirement age flexible and penalizing early retirement as well as rewarding prolonged employment.

The fifth measure can be seen to be the establishment of various sustainability factors or demographic factors i.e. techniques which take into account population ageing in pension calculation (e.g. Sweden, Italy, Finland, Germany, Austria, and France).

Of course it would be possible to make an increasingly nuanced catalogue of reforms but then we would run the risk of drowning in the details. To take a step forward and get back closer to Pierson's and Hall's classifications I will use the World Bank's classification for summarizing the reforms implemented in the countries studied. The WB's classification can be seen to combine elements of structural classification analysis as well as Hall's and Pierson's approaches. According to the World Bank's (Holzmann et al. 2005, 61) categorization, there are five main options for reforming typical publicly managed, unfunded, defined-benefit pension schemes. Reform options arise from different sets of

combinations of benefit type (DB/DC), administration (public/private) and funding (unfunded/funded). These are:

- *Parametric reforms* that keep the structure of benefits, public administration and unfunded nature of the system but change key elements of the parameters;
- *Public prefunding* that provides defined benefits or defined contributions that are publicly administered;
- *Notional defined-contribution reform* that changes the structure of benefits but keeps public administration and the unfunded nature of the system;
- *A market-based approach* that provides fully funded (defined-benefit or defined-contribution) benefits under private management. Under this kind of reform the publicly administered unfunded pension system is restricted to the zero or basic pillar dealing with purely poverty-alleviation purposes; and
- *Multipillar reforms* that diversify the structure of benefits, administration and funding of the pension system. This approach could be seen in nearly all countries with loose definition. However, this approach refers to the World Bank's model of pension systems and diversifies the benefit structure, funding and administration simultaneously. As such this kind of reform process is referring more to the development in the new EU countries than the EU-15 countries.

Parametric reforms and public prefunding can be seen as 1st or 2nd order changes according to Hall's categorization. The other reforms represent 3rd order changes or Pierson's recommodification and structural change. An overview of pension reforms using the categorization above is given in Table 3.

Table 3. *Main characteristics of the reforms established since the end of the 1980s.*

	Nordic	Anglo-Saxon	Continental
<i>Parametric reforms</i>	FI, DK	-	AT, BE, FR, LU, NL, PT, ES, EL, DE
<i>Public prefunding</i>	-	IE	PT, ES, NL, FR, EL, BE
<i>Notional defined-contribution</i>	SE	-	IT
<i>A market based approach</i>	-	UK, IE	-
<i>Multipillar reforms</i>	-	-	-

According to this classification, 3rd order changes have been made in Sweden and Italy as well as in Britain and Ireland. Actually, the reforms in the last two countries are mainly strengthening the features of the welfare state type to which they belong. Even though this classification helps us form overall picture of reforms this picture is still too general and static to reveal the variation of pension changes. As countries in their social policy development pass through different phases results from short-term cross-sectional analyses are sensitive to the point in time on which the analysis is based. In addition, changes are usually incremental and their real impacts are not always immediately visible; rather, it

takes years before the full consequences materialize. (Hinrichs & Kangas 2003.) That is why we must take another step further. First I will do a closer country-specific analysis and thereafter expand the time span to see how much pension systems will actually change.

3.1 The majority of actual pension reforms are parametric reforms

As presented at the beginning of the paper it is not surprising that nearly all corporatist countries have concentrated only on recalibration or cost containment measures. However, while as such these will not by themselves lead to structural changes, parametric reforms can be a crucial precursor for a more far-reaching paradigmatic reform as they change the liabilities under the old system and may thus pave the way for smoother transition to a new system and benefit structure (Holzmann et al. 2005; Hinrichs & Kangas 2003). A new kind of interplay between public and private pension systems can be found in some countries when studying the issue more deeply.

The pension reform in Germany in 2001 with the introduction of a voluntary pension saving scheme (so-called Riester pension) alongside cuts in public pension provision has been described as a path-breaking law which will over time substantially alter the institutional logic of the pension system (Hinrichs 2002, 2004 and 2005; Lamping & Rüb 2004; Schmähl 2004; Börsch-Supan & Wilke 2006). Introduction of fully-funded old-age provision within the pension system will shift the PAYG system towards a new public-private mix. Pensions are no longer exclusively guaranteed by the statutory system and the pension system has as such diverted from its traditional path. This movement has further been strengthened by 2004 reforms with introduction of a sustainability factor slowing the pensions adjustment as well as establishment of target values for the contribution rate and pensions level. The pension contribution rate is not allowed to rise over 20% by 2020 nor over 22% by 2030. However, the lower limit of the level of pension provision before tax should not fall below 46% of the average wage by 2020 and 43% by 2030. Before these path-breaking reforms Germany had carried out some cost containment reforms and reform efforts in the 1990s (e.g. the demographic factor was delayed in the 1999 reform) (see e.g. NSR Germany 2005, 51; Börsch-Supan et al 2006).

Austria carried out moderate and purely parametric reforms in the 1990s, but the latest pension reforms carried out in 2003 and 2004 are clearly a step in a more radical direction. Reforms e.g. extend the assessment period for pensionable earnings from 15 to 40 years and increase the number of insurance years required for a full pension from 40 to 45 years (annual accrual rate is diminished from 2% to 1.78% by 2009). It has been calculated that the reforms will result in a significant decrease in pensions. The decrease has, however, been limited to 10% compared to the situation before the 2004 reform. However, at the beginning of 2005 the uniform pension law for all occupational groups entered into force. In consequence, this "new pension system" will gradually replace the plethora of several

different pension schemes. Also the cap of 10% on pension losses will gradually be phased out, in particular after 2033 when the harmonisation of the public pension systems will be fully effective. Austria has also established a sustainability factor in 2005. No automatic adjustment enters into force but a separate expert committee will review financial developments in the pension system every three years and is obliged to put forward respective proposals affecting the retirement age, the contribution rate and the pension adjustment to the government. (AWG 2006.)

In other Continental countries reforms have been at best moderate. The resistance to change can not be said to be due to a better financial or demographic situation than in other countries. Only Luxembourg and the Netherlands face relatively less serious demographic and economic challenges. However, also in Luxembourg the projected rise in pension expenditure is among the highest in the EU-15 (Figure 2). Reforms established so far in the 1990s and early 2000s have mainly concentrated on harmonization of the level of pensions in the private and public sectors.

In the Netherlands the most visible reform was carried out in 1998 when the upper limit of 18.25% to the basic scheme's (AOW) old-age pension contribution (17.9% in 2005) and the AOW Pension Savings Fund was set up. The Netherlands is committed to maintaining the basic pension in its present form even though public spending on pensions is expected to increase and also the reserve fund will be melt down after 2020. Any extra money needed to fund pensions will be covered by taxation. (NSR 2005 Netherlands.)

In France a reserve fund was established in 1999. Pension reforms in 1993 and 2003 introduced limited retrenchments. According to Palier (2000), governments in France have long preferred to increase social contributions than to cut benefits. However, with the reform of 2003 a link between the level of pension and average life expectancy was established. As a result, the period of contributions required to have a full pension (at the moment 40 years) will develop in line with increases in life expectancy. It is projected that years required for full pension reach 41.75 years by 2020. At the moment, the trend is also towards developing private pension saving schemes. The pension reform in 2003 introduced also two new voluntary pension vehicles: savings-retirement plans implemented by companies for their employees (PERCO) and the individual Popular Pension Saving Plan (PERP). (Palier 2002; Mandin & Palier 2005.)

In Portugal the most significant measure has been the change in pension formula in 2002, which is after the renewal based on life-time earnings instead of the average income of the best ten years over the last fifteen. In Belgium, Spain and Greece pension systems have remained quite intact. In Spain the most visible reform has been the lengthening of the period from which the pensionable wage is calculated (from eight to fifteen years). If compared to other EU-15 countries, only in Greece the period is shorter at the moment. All these countries have established buffer funds to bring alleviation for future expenditure. In

Portugal a reserve fund has been in place since 1989, in Spain as part of the Toledo Pact in 1997, in Belgium in 2000 and in Greece in 2002.

Of the Nordic countries Denmark has introduced new institutions into the pension system which is known as a typical basic security country with no earnings-related pension. A temporary pension savings scheme was first adopted in 1997 and made permanent (Special Savings Scheme, SP) in 1998. This brought a linkage that otherwise has been absent from the Danish welfare state: future benefits are linked to individual contributions. However, Petersen (2005) describes the system as more an instrument of fiscal policy rather than a genuine pension system. This is due to its minor contribution level (1% of the wage) and suspending of the contributions for the years 2004–2006. However, Andersen (2000) has labelled the pension evolution in Denmark as drifting or silent revolution (compared to the Swedish "revolution") (see also Andersen & Larsen 2002). He also asks whether gradual and non-visible reforms implemented in the statutory pension system during the 1980s and 1990s as well as the growth of occupational pension coverage have changed the basic structure of the Danish pension system so that one can even speak of a third-order change. It has also been stated that the Danish retirement system is a multi-layered system following the former three-pillar concept developed by the World Bank (James 1997).

In Finland such a system shift as such cannot straightforwardly be said to have happened. There has been no active policy for development of private pension provision or a "multipillar pension system". Thus, Finland still has a "one-pillar approach". One specific feature of the Finnish earnings-related pension scheme is that there is no income or pension ceiling. The incremental changes made throughout the 1990s have been made within the existing institutional structure. One decisive structural change inside the statutory pension structure has been the crowding-out of the national pension as it was made pension-tested in 1996. The 2005 reform, especially the establishment of the life expectancy coefficient and a new calculation method taking into account earnings of the whole employment will over time leave space also for voluntary pension arrangements, passively though. A declining replacement rate may trigger an expansion of voluntary supplementary pension schemes. On the other hand, other changes (higher accrual rates after age 52 and especially after age 63) encourage people to work longer and thus compensate for the otherwise diminishing pension level.

3.2 Notional defined-contribution reform has been established in Sweden and Italy

Pension reforms in Italy and Sweden have made the most crucial change: defined-benefit pension systems have been changed to defined-contribution ones. The difference between these two countries is that in Sweden part of the pension contribution is funded and

individuals have free choice to invest this part of the pension contribution (i.e. 2.5 percentage points of the 18.5 per cent old-age pension contribution). Otherwise in both countries the pension accrues in the new system on a defined-contribution basis, though without funding (i.e. contributions are credited to notional accounts).

Sweden started to plan its path-breaking pension reform in the early 1990s and passed most of the legislation in 1998. Italy made several consecutive parametric changes at the beginning of the 1990s and a more wholesale change in 1995. In both countries there is a gradual phase-in period of the reforms. In Sweden new pensions – for persons born in 1954 and drawing a pension at age 61 – will be calculated based entirely on the new provisions in 2014. In Italy the reform adopted in 1995 does not come fully into force until 2034. As the financial pressures are high in Italy, it has also been forced to implement further reforms to speed up the cost-saving effects of the 1995 reform. The latest parametrical reforms have been established in the legislation of 2004 concerning eligibility requirements for seniority pensions (i.e. pensions granted on the basis of long insurance periods).

Sweden with its individual accounts is in a way even more outside the path-dependency pattern than Italy. However, Italy has also taken steps towards individual pension accounts. Starting from 2008 employees have option to invest about 7% of earnings into private pension funds as the severance pay system (*trattamento di fine rapporto*, TFR) is reformed.

3.3 A market based approach in UK and Ireland

The movement to market-driven investments can most clearly be seen to be the guiding principle in Britain and Ireland. Reforms carried out have only reinforced the logic of the liberal welfare state.

Britain has constructed a pension system emphasizing the importance of private pensions already since the beginning of the earnings-related pension scheme (SERPS in 1978). Workers with an occupational or a private pension system were able to contract out of SERPS. The attractiveness to opt out was raised by parametric reforms in 1986. At the moment about 60% of the employed are in such contracted-out schemes. SERPS was replaced by the State Second Pension (S2P) in 2002, providing a higher replacement rate for low wage-earners.

The strategy in Britain is to shift pension provision responsibility from public to private. It has been stated that the objective is to increase the share of private pension provision from the present 40 per cent to 60 per cent by 2050. There are also plans for moving the S2P towards a flat-rate scheme. This means that in future pensions are more and more derived from occupational pension schemes and personal pension plans. Actually the shift of pension provision burden is more and more onto individual employees. Employers are replacing their final-salary schemes with defined-contribution plans, thus transferring risks entirely to individuals. Stakeholder pensions were introduced in 2001 to encourage more

individuals especially in the low and middle-income brackets to start saving in pension plans.

Pension strategy is clearly twofold in Britain. The target is to shift pension provision to the private sector while guaranteeing adequate incomes for the poorest pensioners. Introduction of a means-tested guarantee (Pensioner's Tax Credit) to raise the incomes of the most disadvantaged group of pensioners clearly forms part of this development. (see also Taylor-Gooby 2005.)

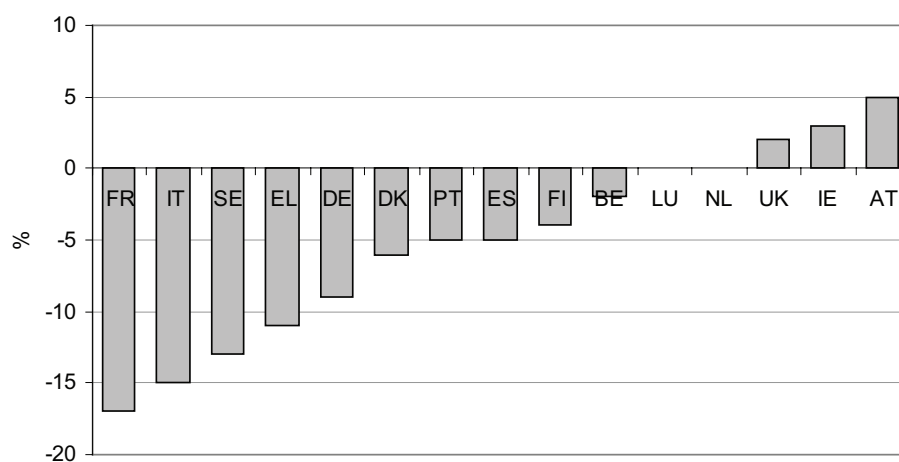
The reform strategy in Ireland is very similar to the British one. Ireland's statutory pension system provides flat-rate pensions only. The government has declared its general goal to raise means-tested basic pensions (non-contributory pensions) significantly by 2007, thus aiming to reduce poverty. Personal Retirement Savings Accounts (PRSA) were introduced in 2002 with the purpose of increasing supplementary pension coverage. In the same manner as in Britain participation in a scheme is voluntary for employees, with employers' obligation to provide access to a PRSA.

4 How drastically do reforms affect the future pensions?

What then is the magnitude of the changes described above? To be able to reveal the impact of small gradual changes and to see whether also these may imply system-shifting elements we should be able to say something about the future. As Taylor-Gooby (2001) has argued, the welfare states are remarkably resilient from a backward-looking perspective, but the outlook is less settled from a forward-looking perspective. To ascertain this I will use theoretical replacement rate calculations.

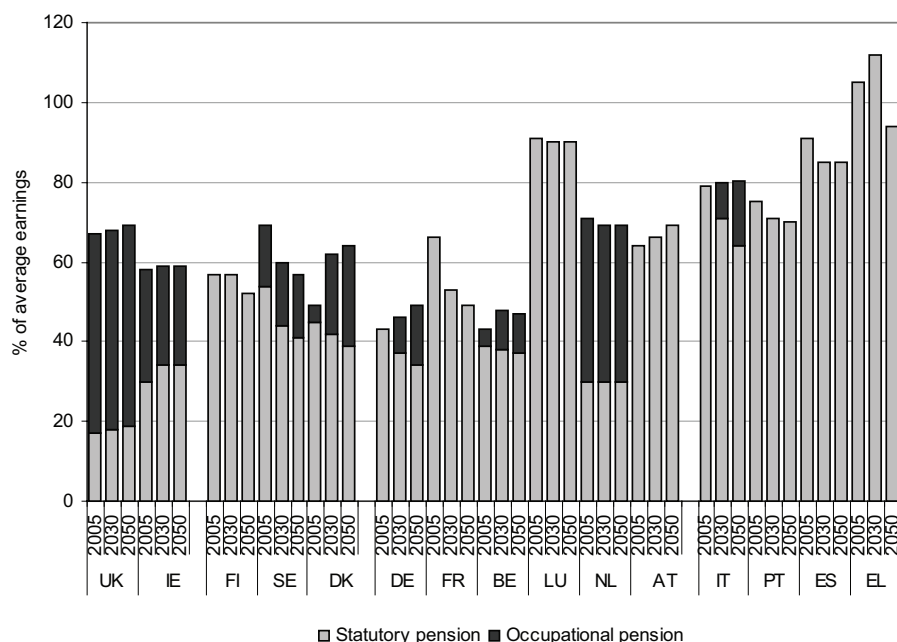
The calculations express the level of pensions as a percentage of previous individual earnings at the moment of take-up of pensions. These are calculated with reference to a hypothetical worker with average earnings who has a 40-year career and retires at age 65. The base year for the calculations is 2005 and the projections are up to 2050 (for more details see ISG 2006). Naturally, as calculations are theoretical the actual representativeness of a chosen case differs between the EU Member States. For example, it is not very common to have a 40-year career in any country represented in the calculations. Even though calculations are sensitive to the set of assumptions used they enable to assess the mechanisms of current and future pension systems. The level of benefits is first and foremost influenced by the structure of the pension system. The fruitfulness of the calculations is that they also reveal the role of private pension provision. Thus, together with the aforementioned country-specific analysis the total picture is more comprehensive. The results are presented in Figures 4 and 5.

Figure 4. *Change in statutory pensions' theoretical replacement rates in percentage points (2005–2050).*



Source: ISG 2006.

Figure 5. Theoretical gross pension replacement rates in 2005 and projected for 2030, 2050 (%).



Source: ISG 2006.

Reduction in pension replacement rates is something that can be expected in countries which have implemented the most visible reforms in their pension system i.e. Sweden and Italy. However, surprisingly the replacement rates are projected to decline most in France: a country with parametric changes. Lengthening the period required for a full pension in pace with average life expectancy and especially the use of price indexation in both basic and supplementary systems decrease significantly the future pension level. As mentioned in the introduction, incremental changes may eventually amount to a system shift. This can be seen happening in France. The reduction in the generosity of the pension systems and reforms promoting the development of pension savings point in this direction. Corresponding findings, signalling a possible system shift in France, have also been presented by Taylor-Gooby (1998) and Palier (2002). Actually, the steps taken in France can be compared to the development of the pension system in Germany.

In addition to aforementioned countries, the cut in pension level is among the highest also in Greece; another country with parametric reforms. Anyway, in Greece the replacement rate is still at a relatively high level at the end of the projection period and the reforms implemented so far do not implicate a radical change or a system shift.

In the rest of the countries the reforms carried out do not seem to lead to drastic changes in statutory pension levels. However, for Austria the result is not very representative as the replacement rate is projected to increase, despite a comprehensive reform described earlier

in this paper. In earlier calculations (prior to the 2004 pension reform) the theoretical pension replacement rate was expected to decrease from a level of 74% to 67% by 2050 (see ISG 2004). In addition, according to the EPC's (2006) projections a significant decrease in the average statutory pension in relation to wage developments is projected.

A feature combining several countries is the growing importance of private pensions for future pensioners. This is so especially in Sweden, Italy, Denmark, Germany and Belgium. In Sweden compulsory occupational pensions will compensate for the reduction in statutory pensions somewhat and become even more of importance for higher income groups. Likewise in Italy the gap in pension provision is expected to be filled with increased participation in private pension funds through the reform of the TFR system. On the other hand, in Denmark the overall replacement rate is to rise due to private pension provision. The projections provide empirical evidence for Andersen's (2000) description of silent revolution or Hacker's (2004) drifting that is taking place in Denmark. Recent reforms in Belgium which aim for increased coverage of private pension provision could be seen as drifting as well or a sort of layering policy applying Hacker's (2004) classification: a new policy is created on top of the old one. This kind of development is even more evident in the Netherlands.

Ireland and Britain represent more a continuum as private pensions have always been a fundamental element of the pension system. However, as can be seen the overall replacement rate is not projected to decrease in future years. On the contrary, in Ireland the government has set the target of raising the state pension to 34% of average industrial earnings. Likewise in Britain the government is proposing (see DWP 2006) to re-link the basic state pension to average earnings. However, the British government's first priority is to establish a new scheme of personal accounts in 2012. In both countries private pension provision is in a decisive role for an insured to attain a better benefit level.

5 Conclusions and discussion

At first sight it is easy to agree with Pierson (1996) as he states how hard it is to find radical changes in advanced welfare states. However, as in pension policy changes are more incremental than revolutionary it is necessary to expand the time span in order to find out what the pension systems will look like in future years and whether a system shift has actually happened. Otherwise the picture of reforms is too simplistic. The central argument of this paper was to show that also small incremental changes may turn out to be drastic, changing the overall picture of the traditional welfare landscape. Thus, excluding changes that have not caused major institutional reform may lead to an underestimation of welfare state cuts. It is important to look beyond changes consisting only of parametric reforms and find those hidden forms of retrenchment as labelled by Hacker (2004). Developments on several levels must be taken into account. The assumption that first and second-order changes signal path-dependency is not always supported. As was shown in this paper, these can over time be seen to lead to path-breaking reforms, changing the logics of the system.

According to the hypothesis presented at the beginning of this paper, the different pension regimes are likely to respond to current pressures for austerity in pension policy in very different ways and the institutional structure of the pension system make Continental countries most resistant to change. It can be seen that countries facing the hardest pressures have not implemented the most radical reforms. In general the reform process appears to be more piecemeal in corporatist countries than in residual or encompassing models. Thus institutions do matter and continuity in pension policy is a visible phenomenon when countries develop their pension systems.

On the other hand, not even the traditional Bismarckian countries have stayed intact. While in Sweden the recent pension reform was carried out in one stroke, in Germany substantial changes come as a result of incremental steps. The landscape of pensions is not as frozen as is often argued. In many countries the income composition of the retiree will change. Private pension provision is projected to increase and this has also been set as one of the visible strategies in many countries, turning retirement income provision into the so-called multipillar approach.

The development of individual pension accounts is one of the most recent trends in industrialized countries. This kind of process can be seen to constitute an essential element and as such a typical trend for Anglo-Saxon countries like Britain and Ireland. In both countries reforms concentrate on targeting the statutory pension system at those in need and finding measures to increase the coverage of private schemes reinforcing the traditional logic of the welfare system. In Britain the most recent plans are a return to a Beveridgean

type of statutory pension system where state pensions are calculated on a fixed-rate basis (DWP 2006).

However, also the Nordic countries Sweden and Denmark have established compulsory individual pension accounts. Likewise Germany, of the traditional social insurance countries, has taken steps towards this kind of policy, i.e. shift of reliance to "new players", to a new kind of public-private mix. In these countries, however, individual accounts are a relatively small supplement to a still very large public pension system.

As nearly all countries are facing increasing financial pressures and the reforms already carried out reduce the level of pensions, the aforementioned tendency indicating qualitative change in the pension system is likely to continue. This is supported by the fact that nowadays much of the discussion evolves around economic competitiveness and in the pension world this has most clearly concretized in discussions around the size of the pension contribution level. A stable contribution rate has become the focus of pension policy. Sweden, Germany and the Netherlands have set certain target levels above which the rate of (old-age) pension contribution shall not be raised. Likewise Italy has moved in the same direction with its reformed pension system. This means subordinating the pension benefits to the contribution rate and thus adjustment of the pension level. In the Swedish and Italian pension system this will happen automatically but in Germany and the Netherlands separate (and severe) political decisions have to be made. In Germany this has already led to the freezing of pension levels since 2004. The Netherlands has stated that the contribution level is not sufficient to accommodate the rising costs of the old-age pension scheme. Other EU-15 countries have not established fixed ceilings for contribution rates but there are efforts to stabilize the rise of contribution rates. For example in Spain the contribution rate has been maintained at 1995 levels. The debate has also started in Finland.

Future reforms in many countries are likely even though retrenchment is not going to be easy. What we are lacking are statistical indicators or empirical evidence which could tell us more about 1st, 2nd and 3rd order changes or the degree of retrenchment. The 'dependent variable problem' is evident and there is a need for developing indicators that could more properly answer the question how large the changes have to be before they are viewed as significant. In this paper minor effort was put towards this kind of presentation through replacement rate calculations. One way to study this topic might be construction of a summary index of the degree of retrenchment. Some efforts towards this kind of approach have already been made (see e.g. Hicks & Zorn 2002; also Mantel 2001) but a lot more effort is needed and this is something which should be concentrated more on in future studies.

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